**September 28, 2018**

# BIR RULING NO. 1211-18

Section 105 of the National Internal Revenue Code of 1997, as amended.

*A.Q. Ancheta & Partners*
Suites 1008-1010 Paragon Plaza
162 EDSA cor. Reliance St.,
Mandaluyong City 1550

Attention: *AAA*
*BBB*

Gentlemen :

This refers to your letter dated February 27, 2018, requesting on behalf of your client, **Daelim Philippines, Inc. ("DPI")**, for confirmation of your opinion that the Delay Liquidated Damages which are to be paid by any or all of the **Contractors** in favor of **Pagbilao Energy Corporation**, for the construction of coal fired power project are not subject to value added tax (VAT).

As stated in your letter, the antecedent facts are as follows:

1. On April 25, 2014, **DPI, Desco, Incorporated ("DI")**, both domestic corporations and **Daelim Industrial, Company, Ltd. ("DICL")**, a non-resident foreign corporation based in Korea (hereinafter collectively referred to as the **"Contractors"**), are engaged in business of construction services. They entered into an Agreement with **Pagbilao Energy Corporation ("PEC")** for the construction of Pagbilao 420 MW Coal Fired Power Project located in Barangay Ibabang Polo, Pagbilao Quezon under an Engineering Construction and Procurement Contract. The guaranteed completion or commercial operation date is set on December 25, 2017.

2. Under the Engineering Construction and Procurement Contract, DPI and DI are "onshore contractors" while DICL is an "offshore contractor."

3. Generally, the Contractors undertook to perform the design, engineering, procurement, permitting, fabrication, construction,

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installation, commissioning, start-up, testing and safe and timely completion of the power facility and the existing facility upgrades.

4. The Contractors also undertook to perform or caused to be performed, on a "Turnkey Basis," all work and services and provide all materials, equipment, machinery, tools, labor, utilities, chemicals, lubricants, consumables, transportation, administrations, oversight and incidentals as may be necessary or appropriate to perform the functions and purposes indicated in the Engineering Construction and Procurement Contract and to provide PEC with the completed power facility and existing facility upgrades, capable of being operated and maintained in accordance with Engineering Construction and Procurement Contract, that will meet the performance criteria and other conditions of the Engineering Construction and Procurement Contract.

5. Under Section 7.3.4 of the Turnkey Contract, in cases of delay or failure to meet the guaranteed commercial operation date of the project, the Contractors will be held liable for reasonable Delay Liquidated Damages. However, there was no provision as to the possible taxes involved in case of payment of the said Delay Liquidated Damages.

6. On the guaranteed completion date, the Contractors committed delay or failed in the delivery of the Project. Consequently, for failure to start its commercial operations immediately after the guaranteed completion date, PEC had sustained anticipated loss of profits.

7. The Delay Liquidated Damages may be collected by drawings from the security bond, retention fees or may be paid directly by any or all the Contractors.

8. As a compromise settlement through a Letter of Agreement by the parties, the Delay Liquidated Damages is determined to be at US$_____, exclusive of VAT which is entirely for the account of DICL. However, the Contractors assert that the Delay Liquidated Damages should not be subject to VAT but only for income tax. On the other hand, PEC contends that aside from income tax, the Delay Liquidated Damages should also be subjected to VAT.

Based on the foregoing, you now request confirmation of your opinion that the Delay Liquidated Damages resulting from breach of contract for the Contractors' failure to meet the guaranteed completion or commercial operation date which resulted to loss of anticipated profits on the part of PEC are not subject to VAT.

In reply, please be informed that Section 105 of the National Internal Revenue

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Code (NIRC) of 1997, as amended, provides that:

> *"SEC. 105. Persons Liable. — Any person who, **in the course of trade or business, sells, barters, exchanges, leases goods or properties, renders services**, and any person who imports goods shall be subject to the value-added tax (VAT) imposed in Sections 106 to 108 of this code.*
>
> xxx xxx xxx
>
> *The phrase "in the course of trade or business" means the regular conduct or pursuit of a commercial or an economic activity, including transactions incidental thereto, by any person regardless of whether or not the person engaged therein is a non-stock, nonprofit private organization (irrespective of the disposition of its net income and whether or not it sells exclusively to members or their guests), or government entity."* (Emphasis and underscoring supplied)

In relation thereto, Sections 4.105-1 and 4.105-2 of Revenue Regulations (RR) No. 16-2005, [1] as amended, states that:

> *"SECTION 4.105-1. Persons Liable. — Any person who, **in the course of his trade or business, sells, barters, exchanges or leases goods or properties, or renders services, and any person who imports goods**, shall be liable to VAT imposed in Secs. 106 to 108 of the Tax Code.*
>
> xxx xxx xxx
>
> *"Person" refers to any individual, trust, estate, partnership, corporation, joint venture, cooperative or association.*
>
> *"Taxable person" refers to any person liable for the payment of VAT, whether registered or registrable in accordance with Sec. 236 of the Tax Code.*
>
> xxx xxx xxx
>
> ***"Taxable sale"** refers to the sale, barter, exchange and/or lease of goods or properties, including transactions "deemed sale" and the performance of service for a consideration, whether in cash or in kind, all of which are subject to tax under Secs. 106 and 108 of the Tax Code.*
>
> *SECTION 4.105-2. Nature and Characteristics of VAT. — **VAT is a tax on consumption levied on the sale, barter, exchange or lease of goods or properties and services in the Philippines and on importation of goods into the Philippines**. The seller is the one statutorily liable for the payment of the tax but the amount of the tax may be shifted or passed on to the buyer, transferee or lessee of the goods, properties or services. This rule shall likewise apply to existing contracts of sale or lease of goods, properties or services at the time of the effectivity of RA No. 9337. However, in the case of importation, the importer is the one liable for the VAT."* (Emphasis and underscoring supplied)

The above-quoted provisions are clear that VAT is levied to any individual, trust,

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estate, partnership, corporation, joint venture, cooperative or association on their sale, barter, exchange or lease of goods or properties and services in the Philippines and on importation of goods into the Philippines. In this case, the Delay Liquidated Damages for failure of the Contractors to meet the guaranteed completion date, represent indemnifications for the unexpected loss of assets, and is not considered as sale, barter, exchange or lease of goods or properties and services in the Philippines, or importation of goods into the Philippines. Hence, the Delay Liquidated Damages which are paid by the Contractors to PEC for the construction of the Pagbilao 420 MW Coal Fired Power Project located in Barangay Ibabang Polo, Pagbilao Quezon under the Engineering Construction and Procurement Contract are not subject to VAT. The Delay Liquidated Damages, however, are subject to income tax, the same being compensation for the loss of anticipated profits.

This ruling is being issued on the basis of the foregoing facts as represented. However, if upon investigation, it will be disclosed that the facts are different, then this ruling shall be considered null and void.

Very truly yours,

**(SGD.) CAESAR R. DULAY**
*Commissioner of Internal Revenue*

**Footnotes**

1. Consolidated Value-Added Tax Regulations of 2005.

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